84-104

No.

IN THE

Supreme Court of the United States

OCTOBER TERM 1984

RUSSELL REDHOUSE, JR.,

PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE,

RESPONDENT

Petition for a Writ of Certiorari to the
United States Court of Appeals for the
Ninth Circuit

ZAYLE A. BERNSTEIN
JACK STEIN
COUNSEL FOR PETITIONER
BERNSTEIN, BERNSTEIN & STEIN
1164 East Oakland Park Boulevard
Fort Lauderdale, Florida 33334
(305) 563-3205

10 pp

QUESTIONS PRESENTED

1) Whether the Commissioner of Internal Revenue, in amending a Treasury Regulation, is exempt from the requirements of the Administrative Procedure Act § 553 (5 U.S.C. § 553) by operation of IRC § 7805(b).

2) Whether § 7805(b) of the Internal Revenue Code of 1954, as Amended (26 U.S.C. § 7805(b)), provides the Commissioner of Internal Revenue with the unlimited authority to retroactively apply treasury regulations notwithstanding noncompliance with the notice requirements of APA § 553(d) and which causes disparity of treatment between similarly situated taxpayers.

3) Whether the United States Tax Court exceeded its jurisdiction in exercising Article III judicial powers over constitutional matters appurtenant to the de-

termination of federal tax deficiency which has denied the taxpayer his rights to due process of law.

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IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1984

No._____

RUSSELL REDHOUSE, JR., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Counsel of Record, on behalf of Russell Redhouse, Jr., petitions for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

The opinion of the Court of Appeals (App. A, Vol II, p. 1) is reported at 728 F. 2d. 1249. The opinion of the United States Tax Court (App. C, Vol II. p. 24) is reported at 79 T.C. 355. (1983).

JURISDICTION

The judgment of the Court of Appeals (App. B, Vol. II, p. 22) was entered on March 20, 1984. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS INVOLVED

1. Section 7805[1] of the Internal Revenue Code of 1954, 68A Stat. 917, as amended

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[1]Citations to provisions of the Internal Revenue Code shall be referred to as "Section" unless otherwise specifically noted.

by § 1906 of Pub. L. No. 94-455, 90 Stat. 1834, codified at 26 U.S.C. § 7805 (1970), provides:

A. Authorization. Except where such authority is expressly given by this title to any person other than an officer or employee of the Treasury Department, the Secretary shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal Revenue.

B. Retroactivity of regulations or rulings. The Secretary may prescribe the extent, if any, to which any ruling or regulation relating to the internal revenue laws shall be applied without retroactive effect.

C. Preparation and distribution of regulations, forms, stamps, and other matters. The Secretary shall prepare and dis-

tribute all the instructions, regulations, directions, forms, blanks, stamps, and other matters pertaining to the assessment and collection of internal revenue.

2. Section 553 of the Administrative Procedure Act, Pub. L. No. 89-554, 80 Stat. 383, codified at 5 U.S.C. § 553 (1970), provides:

A. This section applies, according to the provisions thereof, except to the extent that there is involved--

1) a military or foreign affairs function of the United States; or

2) a matter relating to agency management or personnel or to public property, loans, grants, benefits, or contracts.

B. General notice of proposed rulemaking shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include--

1) a statement of the time, place, and nature of public rulemaking proceedings;

2) reference to the legal authority under which the rule is proposed; and

3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.

Except when notice or hearing is required by statute, the subsection does not apply--

a) To interpretative rules, general statements of policy, or rules

of agency organization, procedure, or practice; or

b) when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.

C. After notice required by this section, the agency shall give interested persons an opportunity to participate in the rulemaking through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose. When rules are required by statute to be made on the record

after opportunity to an agency hearing, Sections 556 and 557 of this title (5 USC §§ 556 and 557) apply instead of this subsection.

D. The required publication or service of a substantive rule shall be made not less than 30 days before its effective date, except--

1) a substantive rule which grants or recognizes an exemption or relieves a restriction;

2) interpretative rules and statements of policy; or

3) as otherwise provided by the agency for good cause found and published with the rule.

E. Each agency shall give an interested person the right to petition for the issuance, amendment, or repeal of a rule.

3. The original Treas. Reg. § 1.612-3(b)(3) provided that:

- The payor, at his option, may treat the advanced royalties so paid or accrued in connection with mineral property as follows:

A. As deductions from gross income for the year the advanced royalties are paid or accrued, or

B. As deductions from gross income for the year the mineral product, in respect of which the advanced royalties were paid, is sold.

For an exception to this treatment when the payor is a sublessor of coal, see paragraph (b)(3) of § 1.631-3. Every taxpayer must make an election as to the treatment of all such advanced royalties in his return for

the first taxable year in which such amounts are paid or accrued. A taxpayer will be considered to have made an election in accordance with the manner in which such items are treated in the return. A failure to deduct any such items for the year paid or accrued will constitute an election to have all such items treated in accordance with subdivision B of this subparagraph. Any election made under this section is binding for the taxable year for which made and for all subsequent years, and the taxpayer must treat all advanced royalties paid or accrued in all subsequent years in the same manner. This paragraph does not grant a new election. Any taxpayer who made an election under paragraph (e) of § 39.23(m)-10 of Regulation 118 (26 CFR (1939) 39.23(m)-10(e)) or corresponding provisions of prior regulations is, by such election, bound with respect to treatment of such advanced royalties whether paid or accrued before or after December 31,

1953. See Section 7807(b)(2). For additional rules relating to elections in the case of partners and partnerships, see Section 703(b) and the regulations thereunder.

4. The proposed Treas. Reg. § 1.612-3(b)(3) provided that:

> - the payor shall treat the advanced royalties so paid or accrued in connection with mineral property as deductions from gross income for the year the mineral product, in respect of which the advanced royalties were paid or accrued, is sold.

However, in the case of advanced royalties paid or accrued in connection with mineral property as a result of a minimum royalty provision, the payor, at his option, may instead treat the minimum royalty payments as deductions from gross income for

the year in which the minimum royalties are paid or accrued. For purposes of this paragraph, a minimum royalty provision requires that substantially uniform royalty payments be made at least annually over the life of the lease.

For an exception to this treatment when the payor is a sublessor of coal or domestic iron ore, see paragraph (b)(3) of §1.631-3. Every taxpayer who pays or accrues advanced royalties resulting from a minimum royalty provision must make an election as to the treatment of all such minimum royalties in his return for the first taxable year ending after December 31, 1939, in which such minimum royalties are paid or accrued. The taxpayer's treatment of such minimum royalties for such first year shall be deemed to be the exercise of the election. Accordingly, a failure to deduct such minimum

royalties for that year will constitute an election to have all such minimum royalties treated as deductions for the year of the sale of the mineral product in respect of which such minimum royalties are paid or accrued. See Section 7807(b)(2). For additional rules relating to elections in the case of partners and partnerships, see Section 703(b) and the regulations thereunder.

STATEMENT OF THE CASE

On November 12, 1976, Edwin Tunick (hereinafter "Tunick"), as the original general partner of Tennessee Coal Resources (hereinafter "TCR"), entered into a lease agreement with L.D. Rowlette (hereinafter "Rowlette"). Pursuant to such lease, Tunick acquired the rights to mine coal from a mine in Clairborne County, Tennessee, plus other assets.

RUSSELL REDHOUSE, JR. (hereinafter "Petitioner") was a limited partner in TCR, a partnership formed on December 30, 1976.

On or about December 31, 1976, Tunick assigned to TCR his rights under the lease, and TCR in turn paid to Rowlette $650,000 cash and a non-recourse note in the amount of $2,350,000 as a prepaid advance royalty pursuant to the lease.

TCR, thereafter, deducted the $3,000,000 as an advance royalty on its 1976 return. The Commissioner of the Internal Revenue Service (hereinafter "Commissioner") disallowed said deduction because no coal was mined in 1976. The Commissioner relied on the amendment to Treas. Reg. § 1.612-3(b)(3) that stated that advanced royalties are to be deducted from gross income in the year the mineral product is sold.

On October 29, 1976, the Internal Revenue Service issued News Release IR-1687 which announced the forthcoming publication in the Federal Register of a proposed amendment affecting mineral leases entered into on or after October 29, 1976. The Internal Revenue Service also announced the suspension of Rev. Rul. 70-20, 1970-1 C.B. 144 (which allowed advanced minimum royalties to be deducted in the year paid or accrued)

and Rev. Rul. 74- 214, 1974-1 C.B. 148 (which permitted a lump-sum payment to be deductible when paid or accrued).

The proposed amendment was published in the Federal Register on November 2, 1976, which announced that public hearings would be held November 30, 1976, and the last date for the submission of comment was November 23, 1976. The lease herein was executed by Tunick on November 12, 1976. The final version of amended Treas. Reg. § 1.612-3(b)(3) was published in the Federal Register on December 19, 1977, thirteen (13) months after the regulation was proposed. T.D. 7523, 1978-1 C.B. 192. The effective date of the regulation was made retroactive to October 29, 1976. This announcement was accompanied by the publication of Rev. Rul. 77-489, 1977-2 C.B. 177, which revoked Rev. Ruls. 70-20 and 74-214.

On March 28, 1980, the Commissioner issued a Notice of Deficiency to Petitioner asserting a deficiency in Petitioner's federal income tax for the calendar year ending December 31, 1976.

On June 8, 1980, Petitioner filed in the United States Tax Court a petition for redetermination of the deficiency set forth in the statutory notice of deficiency. The United States Tax Court had subject matter jurisdiction of this matter pursuant to Rule 20 of the Rules of Practice and Procedure, United States Tax Court.

The United States Tax Court consolidated Petitioner's case with those of other TCR partners[2] who had filed petitions

[2]Cases of the following petitioners were consolidated therewith: Irwin M. Adler and Helene E. Adler, docket No. 5709-80;

in the United States Tax Court after receiving similar statutory notices of deficiency.

The Tax Court, on August 23, 1982, issued its finding of fact and opinion and held that: the procedure used by the Commissioner in amending Treas. Reg. § 1.612-3(b)(3) complied with the purpose behind 5 U.S.C. § 553(d) of the Administrative Procedure Act (hereinafter "APA")(App. C, infra, 50-51); the Legislative Reenactment Doctrine cannot be applied to bar reasonable amendments to regulations where the change is made only prospectively from the date of the

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Brent W. Trump and Cheryl A. Trump, docket No. 5710-80; Ronald Glassman and Lenora Rae Glassman, docket No. 5711-80; Stephen L. Nemerofsky and Nina B. Nemerofsky, docket No. 5712-80; Gerald L. Gunderson and Judith C. Gunderson, docket No. 5769-80; Sherwin Ross and Marlynn Ross, docket No. 5771-80; Roman M. Wenzel and Emily A. Wenzel, docket No. 5772-80; Wilbur F. Helmus, Jr., and Patricia Helmus, docket No. 5773-80.

announcement of the proposed change by the Internal Revenue Service in News Release IR-1687, published in the Wall Street Journal. (App. C, Infra, 52-53). The Tax Court further held that retroactive application of amended Treas. Reg. § 1.612(b)(3) was not an abuse of discretion by the Commissioner under § 7805(b) of the Internal Revenue Code (App. C, Infra, 51-53). The Tax Court entered a decision against Petitioner on March 17, 1983 (App D., Infra, 68). However, in the Tax Court's findings of fact, it held that the transaction had economic substance and purpose and was not just for the mere avoidance of taxes. (App. C, Infra, 32-33).

Petitioner, pursuant to 26 U.S.C. § 7482, filed a Notice of Appeal to the

United States Court of Appeals for the Ninth Circuit on June 6, 1983.[3]

The Ninth Circuit, on March 20, 1984, affirmed the decision of the Tax Court and held that the retroactive application of Treas. Reg. § 1.612-3(b)(3), T.D. 7523, 1978-1 C. B. 192 was not an abuse of the Secretary of Treasury's discretion under Section 7805(b) (App. A, Infra, 5-11). The Court also stated that the 30-day notice requirement of 5 U.S.C. § 553 was not applicable to the treasury regulation since it was an interpretative regulation (App. A, Infra, 13-16). Finally, the Court rejected Petitioner's arguments that the Tax Court lacked subject matter jurisdiction to decide whether the regulation compiled with the APA and that

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[3]The remaining TCR partners filed a Notice of Appeal in the United States Court of Appeals for the Eleventh Circuit on June 8, 1983; docket no. 83-5543.

the exercise of the judicial power of the United States Government through the ruling by the Tax Court on such regulation constituted a deprivation of due process on the basis that these issues were improvidently raised. The Ninth Circuit held that the Tax Court had jurisdiction to determine the correct amount of any deficiency owed by Petitioner and therefore was allowed to determine whether or not the tax statutes, regulations and rules are valid (App. A, infra, 17-18). The Ninth Circuit permitted an Article I Administrative Court to determine the compliance or lack of compliance by the Internal Revenue Service with the APA.

REASONS FOR GRANTING THE PETITION

1. THE NINTH CIRCUIT IMPROPERLY EXEMPTED THE INTERNAL REVENUE SERVICE FROM THE NOTICE REQUIREMENT OF THE APA, REQUIRING THIS COURT'S REVIEW

Congress, by enactment of the APA, established the procedure which all government agencies must follow when engaging in rulemaking. Specifically, Section 553 of the APA provides that all government agencies must publish a notice of proposed rulemaking in the Federal Register, provide interested persons with an opportunity to participate in the rulemaking, incorporate in the rulemaking a concise statement of the basis and purpose of the proposed rule, and publish a substantive rule in the Federal Register 30 days before its effective date. The latter requirement does not apply to substantive rules which grant or recognize an exemption or reserve a restriction, to interpretative

rules and statements of policy, or for good cause found and published with the rule.

The Ninth Circuit, in holding that § 553(d) of the APA was not applicable to the case Sub Judice, concluded that it was doubtful that the Commissioner, in amending or adopting a treasury regulation, was required to comply with the 30-day notice requirement of § 553(d). (App. A, infra, 15). Further, the Court stated that the amendment at issue here falls under the category of being an "interpretative rule". (App. A, infra, 15-16).

The Ninth Circuit's decision in this case, for the first time, initiates a precedent for any government agency to apply its regulations to avoid the procedures mandated by Congress in the APA.

Section 553(a) of the APA states that the notice requirement shall apply absent certain specified exceptions. By its holding in this case, the Ninth Circuit has improperly exempted the Internal Revenue Service from the notice provision of the APA since such exemption can only be provided by Congressional action.

More specifically, Section 553(a) of the APA states:

a) This section applies according to the provisions thereof, except to the extent there is involved (1) a military or foreign affairs function of the United States, or (2) a matter relating to agency management or personnel or to public property, loans, grants, benefits or contracts.

Despite the Internal Revenue Service's own regulations, which mandate compliance by

the Commissioner with the requirements of APA § 553 when formulating and adopting rules and regulations (See 26 C.F.R. 601.601(a)(2)(d) and 26 C.F.R. 601.702(a)(1)), the Court exempted the Internal Revenue Service from such compliance. This decision, when coupled with the holding of the Tax Court in Wing v. Commissioner, 81 T.C. 17 (1983),[4] must be read

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[4]The Tax Court in Wing v. Commissioner, 81 T.C. 17, 30 n.17, without referring to any authority states:

"Even though in Wendland we stated that we see no inherent conflict between the APA and the Code, were such a conflict to in fact be unavoidable, this would not alter our decision. The APA is a general statute, applying equally to all Federal agencies (unless excepted). The Code, and more specifically sec. 7805, reflects a specific Congressional action to address a particular issue (the power of the Secretary to establish regulations necessary to accomplish the raising and collecting of revenue). If two statutes conflict or overlap in application, the rule is that the more specific of the two takes precedence. As stated by the Supreme Court:

'for it is familiar law that a specific statute controls over a general one "without

as exempting the Internal Revenue Service from compliance with the requirements of the APA in general.

Neither the APA nor the Internal Revenue Service's own regulations provide the Commissioner with an exemption from the requirement of publishing in the Federal Register a substantive rule at least 30 days before its effective date. Nowhere does the APA or the Internal rules of the Internal Revenue Service authorize the alternative publication of regulatory changes, such as in a newspaper publication as was done in the instant case.

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regard to priority of enactment. Bulova Watch Co. v. United States, 365 U.S. 753, 758 (1961)".'"

Petitioner disagrees with the above position inasmuch as the original power to create the regulation springs from Section 611 of the Internal Revenue Code not Section 7805 of the Internal Revenue Code, thereby making the above analysis logically improper.

The Eighth Circuit and Tenth Circuit in United States v. Gavrilovic, 551 F.2d 1099, (8th Cir. 1977) and Rowell v. Andrus, 631 F.2d 699 (10th Cir. 1980), respectively, based on the legislative history, construe APA § 553(d) as establishing a separate requirement that a substantive rule be published in the Federal Register in final form not less than 30 days before its effective date.

However, the Ninth Circuit, although silent on the issue of a separate requirement for publication, in Washington State Farm Bureau v. Marshall, 625 F.2d 269, 306 n.19 (9th Cir. 1980), held that the 30-day notice requirement of § 533(d) applies to the publication or service of the notice of proposed rulemaking required by APA § 553(b). This is in direct conflict with the holdings in the

Eighth and Tenth Circuits and mandates review.

The APA was enacted to provide that administrative procedures affecting individual rights and obligations be promulgated pursuant to certain stated procedures so as to avoid the inherently arbitrary nature of unpublished ad hoc determinations. Morton v. Ruiz, 415 U.S. 199 (1974).

The legislative history of § 553(d) reveals that the purpose of the time lag following publication of a regulation in final form is to "afford persons affected a reasonable time to prepare for the effective date of a rule or rules or to take any other action which the issuance of the rules may prompt." Gavrilovic, 551 F.2d at 1104. It is apparent that APA § 553 was designed with the specific

legislative intent of requiring non-exempt agencies, such as the Internal Revenue Service, to publish in the Federal Register new substantive rules. The notice requirement is based on fundamental principles of fairness and due process.

A taxpayer should be able to rely on currently published regulations to properly plan for the consequences emanating from his business transactions. The conclusion reached by the Ninth Circuit permits the Internal Revenue Service and other agencies to circumvent the APA rulemaking requirements, and abrogate these fundamental principles, which will result in arbitrary, ad hoc determinations.

The Ninth Circuit's misunderstanding of Section 553 of the APA and its misapplication of the APA to this case has created a con-

flict among the circuits which mandates a review by this Court.

The Ninth Circuit alternatively stated that the Internal Revenue Service need not comply with APA § 553 because Treas. Reg. § 1.612-3(b)(3) was an "interpretative rule" which came within an exception to the publication requirement. The Ninth Circuit based its holding on the fact that the regulation was amended "in order to revoke an erroneous interpretation of the earlier regulation." The supposedly erroneous interpretation of Treas. Reg. 1.612-3(b)(3) was based upon two revenue rulings (Rev. Ruls. 70-20 and 74-214) that gave this regulation an overbroad construction. (App. A, infra, 16).

The Court's reasoning for holding Treas. Reg. § 1.612-3(b)(3) as an interpretative rule is incorrect. This holding is in con-

flict with the Fifth Circuit's decision in Green v. United States, 460 F.2d 412 (5th Cir. 1972). The Fifth Circuit, in Green, was reviewing Treas. Reg. § 1.611-2, a regulation adopted at the same time as Treas. Reg. 1.612-3(b)(3) pursuant to the Commissioner's authority under Section 611. The Fifth Circuit, in a footnote to its opinion in Green 460 F.2d at 417, n.4, discussing Treas. Reg. 1.611-2 stated that:

> It is well settled that Treasury regulations are binding on the Government as well as on the taxpayer. E. g., Brafman v. United States, 5 Cir. 1967, 384 F.2d 863, 866. Moreover, regulations long continued without substantial change are considered to have received Congressional approval and have the force of law. United States v. Correll, 1967, 389 U.S. 299, 88 S.Ct. 445, 19 L.Ed.2d 537. Although there is no precise cut-off point when a regulation achieves sufficient venerability to warrant recognition, we have no trouble concluding that the regulation before us must govern the valuation of the remainder interests sold by Central Oil Company. The regulation was promulgated in 1960, has survived a

> major tax reform act which focused considerable attention on mineral income taxation, and, in any event, we do not understand the Government to contest the applicability of the regulation.

Implicit in the Fifth Circuit's decision in Green, the court found the regulation to be legislative.

Moreover, in Wing v. Commissioner, 81 T.C. at 28, the court reviewed the applicability of the APA to Treas. Reg. § 1.612-3(b)(3) and stated:

> However, in the instant case, section 1.612-3(b)(3), Income Tax Regs., was promulgated pursuant to specific statutory authority. Section 611(a) provides that taxpayers are allowed a reasonable allowance for depletion to be made under regulations prescribed by the secretary." In addition, section 1.611-0, Income Tax Regs., provides in part:
>
> Where regulations have been enacted pursuant to a specific statutory authority in addition to that provided by section 7805(a), we have afforded them great weight.

> We therefore agree with petitioner that section 1.612-3(b)(3), Income Tax Regs., is a substantive rule, legislative in character and therefore is subject to the basis and notice requirements of 5 U.S.C. secs. 553(c) and 553(d).

The decision of the Tax Court in Wing that Treas. Reg. 1.612-3(b)(3) is a legislative regulation is substantiated by the Fifth Circuit's decision in Green.

The court's rationale for its decision in this case was based on the need to correct the severely broad construction given Treas. Reg. § 1.612-3(b)(3) by Rev. Ruls. 70-20 and 74-214. However, the alleged erroneous interpretation asserted was not contained in the treasury regulation, but in the two revenue rulings. The Ninth Circuit's opinion is silent as to any impropriety of the regulation itself. Revenue Rulings merely represent the opinion of the Commissioner

and, as such, can be revoked retroactively if contrary to law. Dixon v. United States, 381 U.S. 68 (1965); Automobile Club of Michigan v. Commissioner, 353 U.S. 180 (1957). In any event, it is not disputed that the Commissioner could have merely retroactively withdrawn the two erroneous revenue rulings and issued a new revenue ruling to provide for a proper interpretation of the treasury regulation as seen by the Commissioner. The Ninth Circuit failed to consider this alternative in its opinion. It should be noted that previous Commissioners had seen no reason to change the two revenue rulings' interpretation of the regulation.

Treasury regulations are broadly categorized into two types: legislative regulations where Congress has delegated the specific authority to the Secretary of the Treasury in certain Code sections to enact

detailed rules; and interpretative regulations containing the Internal Revenue Service's interpretation of the various sections of the Code which serve to provide guidance to the taxpayer and service personnel. Rogovin, "Four R's: -- Regulations, Rulings, Reliance and Retroactivity - A View From Within." 42 Taxes 756 (1975), 9 STAND. FED. TAX REP. (CCH)¶ 5980A.015.

Treas. Reg. § 1.612-3(b)(3) was a legislative regulation, promulgated pursuant to the legislative authority granted the Secretary of Treasury under § 611(a), which granted the Commissioner the authority to make reasonable allowances for depletion. The Ninth Circuit, in its decision, misconstrued this regulation and held it to be an interpretative regulation. The Ninth Circuit's analysis attempted to compare the APA with Section 7805(b), but should have

compared the APA with Section 611 of the Internal Revenue Code.

The history of Section 611 of the Code establishes the legislative authority for the issuance of Treas. Reg. § 1.612-3(b)(3). Section 23(m) of The Internal Revenue Code of 1939 (hereinafter "1939 Code") (the predecessor of § 611) contains a specific grant of legislative authority to prescribe regulations for determining the amount of reasonable allowance for depletion deduction. The 1940 predecessor of Treas. Reg. § 1.612-3(b)(3), T.D. 4960, 1940-1 C.B. 38, as amended 26 C.F.R. § 39.23(m)-10 (1939), was clearly issued pursuant to the authority of § 23(m) since the regulation was numbered under that section.

This point is further strengthened by Reg. § 1.611-0 which states "§§ 1.611 through

1.614-8 inclusive, are prescribed under the authority granted the Secretary or his delegate by § 611(a) of the Code..." The regulation on its face boldly states that Reg. § 1.612-3(b)(3) was adopted pursuant to the authority of § 611(a).

Clearly, the amendment to Treas. Reg. § 1.612-3(b)(3) was "legislative" which changed the meaning of the regulation requiring the Commissioner to comply with the APA.

The Ninth Circuit's decision allows the circumvention of the protection provided to the public in the APA by requiring publication of final regulations. If the decision is allowed to stand, the Commissioner will no longer need to publish or provide notice to the public of changes in a substantive rule of long-standing, as the

opinion of the Ninth Circuit allows the mere publication in a newspaper to sufficiently change the substantive tax laws of the country. Congress could never have intended this result when it enacted the APA. The prior regulation has been implicitly categorized as legislative in the case of Green, 460 F.2d at 417, has not been rebutted by the Government in its Brief, nor distinguished by the Ninth Circuit in its opinion. Sound legal reasoning will not justify a finding that the regulation is not legislative.

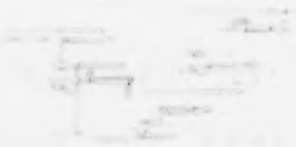
The Ninth Circuit opinion is difficult to reconcile in light of the above subsequent Tax Court decision holding the regulation to be substantive in character. Therefore, this Court should review the appellate ruling under its powers of supervision.

2. WHETHER § 7805(b) OF THE INTERNAL REVENUE CODE OF 1954, AS AMENDED (26 U.S.C. § 7805(b)), PROVIDES THE COMMISSIONER OF INTERNAL REVENUE WITH THE UNLIMITED AUTHORITY TO RETROACTIVELY APPLY TREASURY REGULATIONS NOTWITHSTANDING NONCOMPLIANCE WITH THE NOTICE REQUIREMENTS OF APA § 553(d) WHICH CAUSES DISPARITY OF TREATMENT BETWEEN SIMILARLY SITUATED TAXPAYERS

A review is required of the decision of the Ninth Circuit affirming the decision of the United States Tax Court granting the Commissioner the unlimited authority to apply treasury regulations retroactively.

Section 7805(b) provides the Commissioner with the authority to prescribe the extent, if any, to which any ruling or regulation relating to the internal revenue laws shall apply without retroactive effect. This power, however, is not unlimited.

The Ninth Circuit in its opinion reaches the conclusion that the Commissioner's power under Section 7805(b) to make



retroactive application of a treasury regulation is unlimited except for review for abuse of discretion. The Ninth Circuit, relying upon its own opinion in Manocchio v. Commissioner, 710 F.2d 1400, 1403 (9th Cir. 1983), states that treasury regulations are ordinarily retroactive to the effective date of the statute to which they relate, unless the Secretary limits such retroactive application. However, in Manocchio, the Ninth Circuit was not reviewing the retroactive application of a treasury regulation, but the retroactive application of a revenue ruling.

Revenue rulings are not endowed with as much weight as treasury regulations. A revenue ruling is an interpretation by the Internal Revenue Service, issued by the National Office and published in the Internal Revenue Bulletin for the information and guidance of taxpayers, service personnel and

others concerned. Rogovin, supra at ¶ 5980A.0167 at 67,045. Revenue rulings basically set forth the Commissioner's position with respect to a particular issue and permit uniform handling of the issue, both in planning and on audit.

Legislative regulations, in contrast to interpretative regulations, are generally given the force and effect of law and are binding on both the Commissioner and taxpayers unless the regulation exceeds the scope of the delegated power, are contrary to law, or are unreasonable.

Interpretative regulations contain the Internal Revenue Service's interpretation of various sections of the Code and establish the Internal Revenue Service's position. These regulations are adopted pursuant to the authority granted the Secretary in Section 7805(a) to prescribe all needful

rules and regulations as may be necessary by reason of any alteration of law in relation to the internal revenue. Interpretative regulations, while being afforded great weight by the courts, interpret the Code and set forth the Internal Revenue Service's position.

Thus, revenue rulings merely state the Commissioner's position on a particular issue and provide guidance thereon, but are not meant to be relied upon by taxpayers. This point was confirmed in Dixon v. United States, 381 U.S. 68 (1965), where the issue before the Court was the Commissioner's authority to retroactively withdraw an acquiescence issued in the form of a revenue ruling. The Court concluded that the United States was not barred from collecting a tax otherwise lawfully due as the result of the

Commissioner's erroneous acquiescence in a decision, published as a revenue ruling.

Both legislative and interpretative regulations may be amended with prospective effect. Helvering v. Wilshire Oil Co., 308 U.S. 90 (1939). There is, however, considerable confusion in dealing with the Commissioner's authority to retroactively amend regulations.

The courts have upheld the Commissioner's authority to retroactively amend revenue rulings where based on error or mistake of law, Automobile Club of Michigan v. Commissioner of Internal Revenue, 353 U.S. 180 (1957); Dixon, 381 U.S. at 73, or to retroactively apply treasury regulations where no regulation previously existed. United States v. California Portland Cement, 413 F.2d 161 (9th Cir. 1969). However, the Commissioner's ability to retroactively apply

amended legislative regulations of long standing is unsettled. While Section 7805(b) permits retroactive application of rules and regulations, it is unclear if Section 7805(b) will permit the retroactive revocation of a long standing legislative regulation.

Treas. Reg. § 1.612-3(b)(3) was adopted in final form in 1960 by T.D. 6446, 1960-1 C.B. 208, along with Treas. Regs. §§ 1.611 through 1.616, pursuant to the Commissioner's power to make reasonable allowances for depletion under § 611. Sections 611 and 612 were derived from Sections 23(m) and 114(b)(1), respectively, of the 1939 Code. Section 7805(b) was not mentioned at all by prior Commissioners of the Internal Revenue for their authority when originally or subsequently adopting the regulation set forth above.

The provision allowing for the advanced royalty election contained in Reg. § 1.612-3(b)(3) was first adopted in explicit regulatory provision in 1940, in T.D. 4960, 1940-1 C.B. 38, as amended 26 C.F.R. § 39.23(m)-10, (1939). Treas. Reg. § 1.612.3(b)(3) remained unchanged from 1940 until December 19, 1977, when the Commissioner published its amended regulation in final form in the Federal Register and applied it retroactively to October 29, 1976, the date of the announcement of the proposed amendment which appeared by way of newspaper publication.

Courts have afforded treasury regulations great weight where they are long continued. The Supreme Court in Helvering v. Winmill, 305 U.S. 79, 83 (1935) stated that:

> Treasury regulations and interpretations long continued without substantial changes, applying to unamended or substantially reenacted

> statutes are deemed to have received Congressional approval and have the effect of law.

This principle was followed in Helvering v. R. J. Reynolds Tobacco Co., 306 U.S. 110 (1939), wherein the Supreme Court sustained the Commissioner's power to change its regulations so as to operate prospectively, but denied the Commissioner's power to apply a new or amended regulation retroactively where the regulation had received the approval of the legislature.

Dean Erwin Griswold, an authority in the area of legislative reenactment as it relates to the Internal Revenue Service, stated in an article on this subject:

> When the Commissioner is dealing with administrative legislation, he should be free to change it prospectively within the scope of the original grant to him of legislative power; he should not be free to change it retroactively, at

least against the interest of the taxpayer.

Griswold, A Summary of the Regulations Problem, 54 Harv. L. Rev. 398, 412 (1941).

Dean Griswold concluded that in certain situations, such as in the early formulative days of a regulation, retroactive amendments may be appropriate, but that once a "regulation has become seasoned, the Commissioner should have no power to make retroactive amendments at least against the interest of the taxpayer." Griswold, supra, at 414. (Emphasis supplied).

The Ninth Circuit, in sustaining the Commissioner's action, acknowledged the concept of legislative reenactment but ignored its application herein. The Ninth Circuit, in its opinion, focused not on whether the regulation was long continued and had been legislatively reenacted, but on the alleged

erroneous interpretation given Reg. § 1.612-3(b)(3) by Rev. Ruls. 70-20 and 74-214. Neither the Ninth Circuit, the Tax Court, nor the Internal Revenue Service have offered any support or authority that the regulation was ever unclear, unsettled, or even vague.

The Ninth Circuit thus permitted the Commissioner to retroactively apply the amendment to Reg. § 1.612-3(b)(3) in order to correct two allegedly erroneous revenue rulings which could have properly been retroactively withdrawn. The Ninth Circuit, in sustaining the Commissioner's action, expands the Commissioner's authority to retroactively amend a regulation without limitations. In this case, the Commissioner justified his actions based upon his determination that his previously issued revenue rulings were incorrect; therefore, the

regulation which the revenue rulings interpreted is incorrect.

Moreover, retroactive application of treasury regulations should not be permitted where its application would be against the interest of the taxpayer or would result in disparative treatment between similarly situated taxpayers. Anderson Clayton & Co. v. United States, 562 F.2d 972 (5th Cir. 1977), cert. denied, 436 U.S. 944 (1978). The Ninth Circuit recognizes this principle, but ignores its application. (App. A, infra, 12). (See also Schuster v. Commissioner, 312 F.2d 311, 317 (5th Cir. 1962).) The Fourth Circuit disagrees with the Ninth Circuit where circumstances such as occurred in Elkins v. Commissioner, 81 T.C. 669 (1983), reveal an unfair disparity in the Commissioner's treatment of similarly situated taxpayers (see, e.g., Farmers' & Merchants' Bank v. United States, 476 F.2d 406

(4th Cir. 1973); International Business Machines Corp. v. United States, 343 F.2d 914 (Ct. Cl. 1965)); or other unusual circumstances are present.

Petitioner points this Court to the recent decision of the Tax Court in Elkins, which involved a taxpayer who after October 29, 1976 (the date of the proposed amendment of Reg. § 1.612-3(b)(3)) invested in and became a partner of a coal partnership formed and obligated to pay advanced royalties prior to this date. The Tax Court in interpreting Reg. § 1.612-3(b)(3) concluded that the partnership was the party to be bound under the regulation and not the partner.

Thus, under the Tax Court's interpretation in Elkins, a taxpayer who invested after October 29, 1976 in a partnership formed and obligated to pay an advanced royalty prior to

October 29, 1976 would not come within the amended regulation. However, a taxpayer who invested after October 29, 1976 in a partnership which was formed and obligated to pay an advanced royalty after October 29, 1976 would come within the dictates of Treas. Reg. § 1.612-3(b)(3) as amended.

This disparity of treatment of taxpayers who are similarly situated is the result of allowing the Commissioner to effectuate substantive retroactive changes in the tax treatment of business transactions without consideration of due process of law.

This result stems from the Commissioner's retroactive application of the amended regulation to an arbitrary date. As such, similarly situated taxpayers suffer inequitable and disparate treatment under Reg. § 1.612-3(b)(3), as amended.

Thus, a review of the Ninth Circuit Court of Appeals decision affirming this action is required.

3. THE TAX COURT EXCEEDED ITS JURISDICTION IN EXERCISING ARTICLE III POWERS OVER CONSTITUTIONAL MATTERS APPURTENANT TO THE DETERMINATION OF FEDERAL TAX DEFICIENCY

A review is required of the Appellate Court's decision affirming the Tax Court's jurisdiction over constitutional issues related to the determination of a Federal tax deficiency.

Petitioner does not argue the constitutionality of the creation of the Tax Court as perceived by the Appellate Court,[5] but rather asserts that the Tax Court, as an Article I Court, lacks subject matter jurisdiction to decide matters of constitutional

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[5] See opinion, Redhouse v. Commissioner, App. A, Vol. II, P. 1, n.2

concern which require due process review. The Tax Court is not an independent, competent judiciary vested with Article III Powers to review compliance of a regulation in accordance with the APA.

The Tax Court, previously called the Board of Tax Appeals, was an independent agency of the Executive Branch until 1969 when it was made an Article I Court by the Tax Reform Act of 1969.[6] Its judges serve for terms of fifteen (15) years and have no rights to undiminished salary as Article III judges do. The court was established solely to determine deficiencies of Federal Income, Estate and Gift Tax liability.[7] Anything not relating to the determination of Federal

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[6] P.L. 91-172, 83 Stat. 730, § 951, 26 U.S.C. § 7441 et. seq.

[7] 26 USC § 7442.

taxes is not within the subject matter jurisdiction of the Court. Section 7441. When an Article I court exercises judicial power, when its judges do not have Article III status, then that court lacks subject matter jurisdiction.

Under the theory of separation of powers, if a function is judicial in nature, it is best performed by an independent judiciary. Congress established the Tax Court as a legislative rather than as a constitutional court and purposefully denied the Tax Court judges the constitutional guarantees of tenure and salary, thereby denying the Tax Court any status as an independent judiciary. In Fairmont Aluminum Co. v. Commissioner, 22 T.C. 1377, 1384-85 (1954), the Tax Court stated that:

> Whatever label might be used to characterize this Court for various purposes, its procedures are, and were intended by Congress to be, in every sense of the word, judicial

> ... We hear and decide only real controversies between adverse parties, following procedures that are inherently judicial. We make no independent investigation of the facts as do some agencies labeled "administrative" either upon our own motion or upon the motion of one of the parties; our findings of fact are based solely on evidence submitted to us by the parties in accordance with prescribed rules. We do not appear as parties in Court to enforce our orders or the law as do so-called administrative agencies. Our findings of fact carry the same weight as those made by a District Court sitting without a jury.

The House Committee on the Judiciary has stated similarly that: "The Tax Court of the United States is already a court in both name and fact, exercising purely judicial functions..."

It has no jurisdiction to exercise the broad common law concept of "judicial power" invested in courts of general jurisdiction by Article III of the Constitution. Burns, Stix

Friedman & Co., Inc. v. Commissioner of Internal Revenue, 57 T.C. 392, 396 (1971). cf. Anthony v. Commissioner, 66 T.C. 367 (1976).

The Tax Court cannot be deemed to be independent of the Treasury Department considering the one-sided success rate of the Government prevailing in this tribunal.[8]

In an analogous case concerning the constitutionality of the Bankruptcy Courts, the Supreme Court stated in Northern Pipeline Construction Company v. Marathon Pipeline Company, 458 U.S. 50, 62 (1982),"...our

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[8] The 1982 Annual Report published by the Commissioner and the Chief Counsel of the Internal Revenue Service revealed that the Government prevailed in 82.7% of all cases tried in the Tax Court. Additionally, the Commissioner of Internal Revenue's report to the Secretary of the Treasury revealed that taxpayers in 1983 won a complete victory in only 4.7% of the regular tax cases in Tax Court compared to 37% in District Court and 50% in Claims Court.

Constitution unambiguously enunciates a fundamental principle -- that the 'judicial power of the United States' must be reposed in an independent judiciary. It commands that the independency of the judiciary be jealously guarded, and it provides clear institutional protections for that independency."

In that case, the Court held that 28 U.S.C. § 1471 unconstitutionally delegated Article III powers to a non-Article III Court (the Bankruptcy Court).

The Ninth Circuit failed to adequately address this issue -- which was raised in brief and in oral argument -- on the basis that it was not properly raised. This is contrary to the Supreme Court's holding stated in Glidden v. Zdanok, 370 U.S. 530 (1965) that subject matter jurisdiction of a

Court can be raised at any time, even on appeal.

The Tax Court must decline to take jurisdiction of a case where it lacks jurisdiction on its own motion even though the jurisdictional ground is not raised by the parties. Ruby, 2 B.T.A. 377(1925); Wheeler's Peachtree Pharmacy Inc. v. Commissioner of Internal Revenue, 35 T.C. 177 (1960). Thus, as in all other instances, a jurisdictional plea may be raised at any time, even on appeal. This is particularly true because of the Court's limited jurisdiction as an Article I, legislative court. In the present case, the court failed to decline jurisdiction of the issue regarding Internal Revenue Service compliance with the APA.

In the instant case, the Petitioner's Constitutional guarantees of procedural due process were abrogated. The Tax Court incor-

rectly exercised its limited powers of jurisdiction and ruled on issues related to compliance with the APA, rather than on issues involving the determination of tax deficiency. The failure of the Tax Court to properly recognize that such action involved constitutional issues which must be considered in an Article III Court setting is a violation of the due process and equal protection clause of the United States Constitution. The Tax Court is not vested with the necessary jurisdiction wherein these issues can be appropriately determined. Section 7441; Northern Pipeline Construction Company, 458 U.S. 50.

The distinction between powers of Article I Courts versus Article III Courts is set forth in McQuiston v. Commissioner of Internal Revenue, 78 T.C. 807 (1982), aff'd, 707 F.2d 1082 (9th Cir. 1983). That case was

decided in the Tax Court by Judge Sterrett, who rendered the Tax Court decision in the instant case.

In McQuiston, Judge Sterrett stated that the Tax Court was an Article I Court and held that it did not have authority to award attorneys' fees for Tax Court litigation under the Equal Access to Justice Act, Pub. L. 96-481, tit. II, Sec. 204(a), 94 Stat. 2327 (effective Oct. 1, 1981). The court reasoned that the Equal Access to Justice Act could only be applied under the jurisdiction of a court established under Article III of the United States Constitution.

The Tax Court's ruling in McQuiston recognized its limitations as an Article I Court, whereas it failed to recognize the same limitations while applying the APA

statutes to the issues presented in the instant case.[9]

This conflicting treatment by the Tax Court of its Article I jurisdiction, and the Appellate Court's subsequent affirmation thereof, sets forth grounds for an exercise of this court's powers of supervision and review on Writ of Certiorari.

This Court should grant certiorari to consider if the Tax Court has jurisdiction to decide matters of constitutional concern which are unrelated to issues involving the collection and determination of a Federal tax liability.

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[9]Congress has since authorized for proceedings commencing after February 28, 1983, the award of reasonable litigation costs where a taxpayer prevails in United States Tax Court and the government's position was unreasonable. See Tax Equity and Fiscal Responsibility Act of 1982, P.L. No. 97-248, Title II, § 292(a), (e)(1), 96 Stat. 324, 572, 574.

CONCLUSION

The case below has rendered a decision which conflicts with the opinions rendered in other circuits (Eighth Circuit and Tenth Circuit) as to the application of the notice requirements of the APA to the Internal Revenue Service. Additionally, this case raises serious issues of Federal law which have not been resolved and thus should be settled by this Court. Therefore, for the reasons and authorities cited herein, the Petitioner strenuously urges this Court to grant its Petition for Writ of Certiorari in this case.

BERNSTEIN, BERNSTEIN & STEIN
Attorneys for Petitioner
1164 East Oakland Park Boulevard
Fort Lauderdale, FL 33334
(305) 563-3205

ZAYLE A. BERNSTEIN

JACK STEIN